

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
SIMCO, INCORPORATED }

Appearances:

For Appellant: Kenneth N. Logan and Robert Bergin,
Certified Public Accountants

For Respondent: Crawford H. Thomas,
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Simco, Incorporated, to proposed assessments of additional franchise tax in the amounts of \$18,211.16 and \$19,859.80 for the income years ended March 31, 1955, and March 31, 1956, respectively.

The issue presented is whether appellant, which derived income from sources within and without California, conducted a unitary business. If the answer is in the affirmative, a determination must be made as to the extent of the unitary business.

During the first income year under review, appellant California corporation, all of whose stock is owned by Dr. M. Laurence Montgomery and his wife, owned and operated farm lands, an orange grove and a small walnut grove in California's Simi Valley. Appellant also owned but did not operate oil properties in this state and owned and operated a Nevada cattle ranch. The oil properties were sold during the first income year. The proceeds were used to finance the cattle ranch.

In January 1956, during the second income year, appellant sold the Simi Valley properties. Again the proceeds

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were used for cattle ranch financing, The cattle ranch operation continued for the entire income year,

The 1250-acre Simi farm land, while a source of grain sales, was also used as grazing land for cattle shipped from Nevada and for cattle purchased locally and first grazed in California. There were 526 head of cattle at Simi the winter of 1954-1955. A significant number of these were sold to California purchasers. The extent of grazing and selling of cattle located at the Simi Valley farm diminished thereafter because of the selling negotiations but did not entirely cease until after the second income year commenced. Additional cattle grazed on other California leased land. Most of appellant's cattle was marketed in the Southern California area.

In addition to the use of the Simi lands for grazing purposes, part of the products grown at the Simi farm were delivered to the Nevada cattle ranch for use as cattle feed. There was also a continuous shifting of men - including the ranch foreman, a soil chemist, and water engineers - between the Simi farm lands and the Nevada cattle ranch.

The management of all the properties was solely vested in Dr. Montgomery, who used his San Francisco medical office as the principal base of operations although he frequently traveled to Nevada. Most insurance was purchased through the San Francisco office. California was also the location for centralization of legal, auditing, and tax services.

The oil properties, orange and walnut groves - were not used in furthering the cattle operation, but, as aforementioned, proceeds from their sale were a source of funds for the cattle ranch operation.

On the theory that the Nevada cattle ranch and all other activities constituted a unitary business, appellant determined income allocable to California by combining its entire income and allocating it by use of the standard three-factor formula of property, payroll, and sales. Inasmuch as there were substantial losses from the cattle ranch operation during the two years under consideration, these losses were thus offset against the income from oil royalties, against the gains from the sale of the oil properties, and against the gains from the sale of all the Simi Valley properties. (Under separate accounting the expenses of operating the Simi Valley properties exceeded income, exclusive of the gains on their sale, for the years in question.)

The Franchise Tax Board computed the California income on a separate accounting basis without regard to the Nevada ranch losses.

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Under one test enunciated by the courts, where the business done within California contributes to or is dependent upon the operations of the business outside the state, the entire business is unitary and the income is to be combined and allocated by the formula method, (Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 16].) This test was one of the tests recently reaffirmed in Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406 [34 Cal. Rptr. 545, 386 P.2d 33], and Honolulu Oil Co. v. Franchise Tax Board, 60 Cal. 2d 417 [34 Cal. Rptr. 552, 38 P.2d 40].

From the facts before us, the conclusion that the business of buying, maintaining and selling cattle was conducted in California as well as in Nevada seems inescapable. In serving as grazing lands and as a source of feed shipped to Nevada, the Simi lands, exclusive of the orange and walnut groves, constituted part of the cattle business. Some personnel shown on the accounting records as a part of the Simi land operation alone, for accounting expediency, were furthering the entire cattle business because of the constant shifting of such personnel between the in-state and out-state operation at the technical, foreman, and worker level. This factor, combined with the land utilization, demonstrates the existence of a substantial degree of mutual dependency and contribution between the Nevada and California operations and supports the finding of a unitary business. Since the Simi Valley farm was an integral asset of the unitary business until it was sold, the gain from the sale was includible in the unitary income. (See Appeal of W. J. Voft Rubber Corp., Cal. St. Bd. of Equal., May 12, 1964.)

We conclude that the business was unitary only to the extent of the Simi farm lands (exclusive of the orange and walnut groves) and the cattle ranch. The only contributions made by the other properties were in serving as sources to help finance the cattle operation. When any entity conducts more than one business the profits from one activity often are used to aid its other enterprises. Any expansion or change by a corporation of its business activities is financed by its own funds or by the use of its credit. If such financing results in a unitary business virtually every business would be unitary no matter how unrelated were the various activities. Neither the courts of this state nor this board have so extended the unitary concept.

Moreover, an entire operation is not unitary merely because its operations are directed from a central office or because its accounting records are kept there, at least where distinct types of businesses are being operated, (Appeal of Industrial Management Corp., Cal. St. Bd. of Equal., June 9, 1959.)

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS **HEREBY** ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Simco, Incorporated against proposed assessments of additional franchise tax in the **amounts** of \$18,211.16 and \$19,859.80 for the income years ended March 31, 1955, and March 31, 1956, respectively, be and the same is hereby modified in that the operation of the Nevada ranch and the Simi farm land is to be treated as a unitary business. In all other respects the action of the Franchise Tax Board is sustained,

Done at Sacramento, California. this 27th day of October, 1964, by the State Board of Equalization.

<u>Paul R. Leake</u>	Chairman
<u>John W. Lynch</u>	Member
<u>Richard Stein</u>	Member
_____	Member
_____	Member

Attest: W. H. Homan, Secretary